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IN THE

Supreme Court of the United States

OCTOBER TERM, 1965

No. 661

FIELD ENTERPRISES, INC.,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

REPLY TO BRIEF FOR RESPONDENT

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REPLY TO BRIEF FOR RESPONDENT

1. *Accrual of Deductions for Sales Commissions.* Respondent agrees that under *Ohmer Register Co.* v. *Commissioner,* 131 F. 2d 682 (6th Cir. 1942), a taxpayer may accrue sales commissions at the time of sale even though they will not be paid if the purchaser defaults in his installment payments, or if previously paid will be repaid in cash upon such default. (Pet. 6; Resp. 9.) Nevertheless, respondent purports to distinguish *Ohmer* from the decision below because petitioner, having paid $42 of the $49 commission at the time of sale and credited the $7 balance (called the quality bonus), may in the event of the purchaser's default recover the $42 through charges against other quality bonuses instead of requiring repayment in cash. (Resp. 7; see Pet. 4.) Thus, respondent would limit petitioner's accrual to $42 while conceding that the entire $49 would be accruable at the time of sale (1) if the entire payment were deferred and would never be made if the purchaser defaulted or (2) if all or a portion were paid at the time of

sale subject to repayment in cash upon the purchaser's default.

Respondent argues that petitioner's method of recovering the $42 paid on sales that later defaulted turned the $7 quality bonus portion of each commission into compensation based on overall performance instead of on individual sales. (Resp. 7-8.) This overlooks the fact that petitioner's commission liability on every bona fide sale was $49, just as it would have been if petitioner had settled with its salesmen in either of the other ways described above. However petitioner settled with its salesmen, the $49 commission on each sale was a fixed obligation unless the purchaser defaulted; it was therefore, a "fixed liabilit[y] within the taxable year" of sale under the *Ohmer* decision, 131 F.2d at 686.

Although respondent calls petitioner's commission system "peculiar" and "unusual" (Resp. 10), the fact is that subscription reference book sellers generally make sales commissions on installment sales dependent on payment by the purchaser of his installment obligations. Approximately 80 percent of sales of such books, which amounted to $410,-800,000 in 1964, are made on the installment basis. Appendix A, *infra*. Other important industries also sell their products on the installment basis under similar commission arrangements. The members of these industries are now faced with conflicting rules for accrual of their sales commissions. (Pet. 6-7.) Sound and equitable tax administration requires that this Court resolve the conflict.

2. *Unauthorized Reexamination.* Respondent attempts to distinguish the decision below from *Reineman* v. *United States*, 301 F. 2d 267 (7th Cir. 1962), on grounds that are irrelevant to the question of law on which the two decisions conflict. (Resp. 13-14.) What the two courts disagreed on was the legal question of whether—if a viola-

tion of the written notice requirement of section 7605(b) is established—invalidation of the resulting deficiency is the appropriate remedy. Respondent's purported distinctions —that petitioner had voluntarily furnished its previously examined records to the second agent and that the first agent had not learned of the quality bonuses—go to the question of whether the taxpayer can complain of a violation, a question not raised here since the Court of Claims held that petitioner had not waived its right to complain.

Moreover, respondent's attempted distinctions are without substantive significance. In each case the second agent obtained access to the books for the previously examined year without disclosing his plans to reexamine that year; neither taxpayer had reason to suspect or to complain of the agent's unauthorized action until it had been completed.* (Pet. 14.) Furthermore, in each case the first agent had full access to the taxpayer's books and thus could have set up the deficiencies subsequently determined by the second agent. (Pet. 32a.) There is nothing in section 7605(b) or in *Reineman* to suggest that enforcement of the advance notice requirement turns on the thoroughness of the first agent's examination.

Respondent's real complaint is with the *Reineman* decision itself; respondent even speculated that the Seventh Circuit would not have followed *Reineman* in this case. (Resp. 14.) That respondent is mistaken in such speculation is evident from the Seventh Circuit's recent statement in *Geurkink* v. *United States,* 66-1 U. S. T. C. ¶ 9144

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*Respondent suggests that section 7605(b) can have no effect where the reexamination has been accomplished surreptitiously because such a reexamination does not "annoy" the taxpayer. (Resp. 12.) It is indeed a novel doctrine that, while a taxpayer whose reexamination is openly requested can object and seek judicial relief, a taxpayer who is subjected to a secret reexamination has no remedy.

(7th Cir. 12/29/65), that *Reineman* stands for the broad proposition that a deficiency assessment "should be set aside because the Commissioner made a *second inspection of taxpayers' books of account* . . . without giving them prior written notice, as required by § 7605(b)." (Emphasis in original.) In view of the conflict between *Reineman* and the decision below and the confused state of lower court precedents, which has engendered a heavy volume of litigation (see 8A Mertens, Law of Federal Income Taxation, § 47.48, notes 88-92.4), the question should be reviewed by this Court.

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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January 10, 1966

THE AMERICAN TEXTBOOK PUBLISHERS INSTITUTE

432 PARK AVENUE SOUTH, NEW YORK, NEW YORK, 10016 212-OREGON 9-6488

December 22, 1965

James B. Lewis, Esq.
575 Madison Avenue
New York, N. Y. 10022

Dear Mr. Lewis:

You have asked that I give you a brief explanation of the nature and magnitude of sales of the subscription reference book publishers and their handling of sales commissions.

During 1964 the gross sales of subscription reference book publishers totaled $410,800,000. Approximately 80% of their sales were made on the installment basis, and virtually all of these installment sales were made through sales people employed on a commission basis. Since the sales in this industry are made on the installment basis, with payment extending over a period of from 5 to 10 months, it is customary to recover a portion of the commission where the purchaser subsequently abrogates the contract, signed at the time of sale. Quite obviously, any question relating to the matching of commission expense to the sale is a matter of importance to the industry as a whole.

The statistics given above are based upon the 1964 Annual Survey of Subscription Reference Book Publishers, compiled by the independent accounting firm of Stanley B. Hunt and Associates, under the auspices of the Reference Book Section Statistical Committee of the American Textbook Publishers Institute.

Sincerely yours,

Austin J. McCaffrey
Executive Director

AJM:eg

APPENDIX A

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